



**NEDGROUP**  
INVESTMENTS

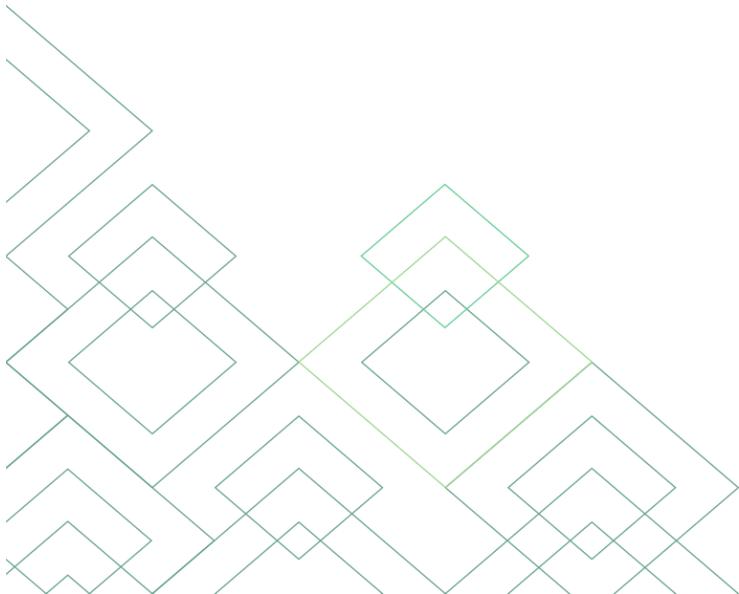
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# **NEDGROUP INVESTMENTS** **FINANCIALS FUND**

Quarter Three, 2023





## Nedgroup Investments Financials Fund

Performance to 30 September 2023	Nedgroup Investments Financials Fund (R class)	Benchmark: FTSE/JSE SA Financials Index
3 Months	4.5%	2.2%
12 Months	21.6%	21.7%

### Market Commentary

The third quarter of 2023 was marked by a modest decline in global stock markets, as investors faced rising interest rates, a strong US dollar, and weakness in China. The US economy showed resilience and avoided a recession, while inflation eased. The Federal Reserve signalled that it would maintain interest rates at these higher levels dampening expectations for the potential of aggressive rate cuts. The sell off in longer-term bonds saw bond yields rise to levels last seen before the Global Financial Crisis. The energy stocks performed well, thanks to higher oil prices, but growth stocks which had been responsible for most of the market's gains for the year lost some of their momentum.

South Africa's economy showed signs of recovery in the third quarter of 2023, after avoiding a technical recession in the previous quarter. The policy uncertainty index, which measures the degree of volatility and unpredictability in the economic environment, eased in the third quarter. The index was influenced by better-than-expected GDP and inflation data, as well as closer collaboration between business leaders and the government on energy, logistics and crime. However, the economy still faced several challenges and risks in the third quarter, such as ongoing power cuts, low consumer confidence and deteriorating public finances.

South Africa's economy faces many structural and cyclical challenges that could hamper its growth prospects. The country needs to implement reforms and policies that can boost its productivity, competitiveness, and resilience in the face of external and internal shocks. That said, asset prices reflect these challenges, and we believe there are well managed business at attractive prices in the SA market and that our philosophy and process are well suited to harness these opportunities for investors.

The rand weakened from R18.83 at the start of the quarter to R18.92. Government bonds with 10 years to maturity saw yields rise marginally from 10.5% to 10.8% over the same period. The FTSE/JSE Capped SWIX Top 40 Index declined by 5%.

### Fund performance

Despite all the negativity about world markets and South Africa the fund has continued to generate very pleasing results (R class return of 4.5% for the quarter and 21.6% for the year) benefitting from five trends:

- Continued demand for credit as the bank sector provides finance for solar energy.
- The benefit from higher interest rates, both in terms of lending spreads and returns on investment assets.
- In line with the rest of the world, very low levels of bad debts proving the effectiveness of the regulatory changes passed post 2008.
- On the insurance side recovery from the past three years high post Covid-19 mortality claims.
- Recovery from the very low valuations.

Investors forget that the sector continues to grow its loan book above inflation, and it is overcapitalised and reserved and, so to speak, 'on the front foot'. The high returns on capital allow it to pay high dividend yields around 7% so, with even a little re-rating, share buy-backs and continued good earnings growth, it is fairly easy to generate a 15%+ return for shareholders.





Top contributors	Ave. weight	Performance attribution	Top detractors	Ave. weight	Performance attribution
Sanlam Ltd	11.2%	0.51%	Standard Bank	6.0%	-0.42%
Discovery Holdings Ltd	-	0.34%	Capitec	5.9%	-0.13%
Momentum Metropolitan Holdings	5.0%	0.29%	Redefine Income Fund	-	-0.08%
Investec Ltd	10.4%	0.29%	Sasfin Holdings	0.5%	-0.05%
Growthpoint Ltd	-	0.25%	Fortress Income Fund	-	-0.04%

Source: StatPro

#### Top 5 contributors

- **Sanlam:** Sanlam performed strongly in the quarter after solid guidance and the subsequent results were reported. The business experienced favourable claims experience in the life business (offset to a small degree by some persistency variances), a rebound in non-life insurance after a tough H122, and strong performance from the credit operations in India as well as better investment markets.
- **Discovery:** We currently have no exposure to Discovery as we have concerns around their financial leverage and cash generation. The results published in the quarter pointed to some improvements, however, we still have our doubts around their ability to scale and grow the emerging businesses and be disciplined in their approach to capital allocation.
- **MMH:** Momentum-Metropolitan Holdings delivered a fairly resilient set of results during the quarter in spite of the challenging macro backdrop. Despite the change in CEO, management remain committed to creating shareholder value through disciplined capital allocation and delivering better returns on capital.
- **Growthpoint:** We continue to hold a negative view on the property sector given macroeconomic headwinds (low growth, high vacancies and higher interest rates) and believe there are more compelling opportunities elsewhere. This helped in that we avoided being exposed to Growthpoint this quarter, which contributed positively. However, as seen below having no exposure to Fortress and Redefine detracted. Growthpoint's results highlighted some of the challenges noted, especially in the Gauteng portfolio.
- **Investec:** Investec has been a strong performer for the fund for a while now as management's execution of a disciplined and focused approach has yielded very strong results. The business released a trading update during the quarter which confirmed the strong performance continues.

#### Top 5 detractors

- **Fortress and Redefine:** As mentioned above, our negative view on the property sector means we currently have no exposure to these two shares. Fortress produced a resilient set of results after some tough prior reporting periods. Redefine provided an encouraging pre-close update pointing to a better outlook in 2024.
- **Sasfin Holdings:** Our small remaining position in Sasfin has detracted this quarter as the business has faced a few operational challenges and announced the delay in publication of its financial results. Subsequent to quarter end though, they announced the decision to dispose of two businesses to African Bank - which is positive. Given liquidity constraints, we are slowly reducing our position in the stock.
- **Capitec:** Capitec delivered a good result but, more importantly, pointed to a peak in credit losses as the outlook improves. Due to the still very high valuation, we maintain a small underweight. Hence, the strong share price detracted from overall performance on a relative basis.
- **Standard Bank:** Similar to Capitec, we are currently underweight Standard Bank and this has counted against us after they published very positive interim results. Having had concerns around the risk in the rest of Africa we perhaps were a bit too negative on the company's prospects. As we illustrate below, we have added to our position as we reassess the investment case and look to reduce our underweight position.





## Current positioning and outlook

We added marginally to the Fund's Standard Bank holdings during the quarter. Standard Bank generates more than 40% of its earnings from outside South Africa and with Sanlam (large investment in India and Africa), Absa (30%+ in Africa) and Investec (50% UK), the Fund generates a large percentage of its growth outside of South Africa. The additional shares purchased, and their price movement, have pushed Sanlam to the third largest investment of the Fund. The top five investments in the Fund remain the Denker Global Financial Fund, FirstRand, Sanlam, Investec and Absa.

## Conclusions

Despite very attractive valuations and solid operational results, investors remain scared to invest in the sector, not only in the US but globally (including South Africa). Investors must guard against 'taking instructions from the market', as Warren Buffett calls it.

*This emotional irrationality has created an investment opportunity for investors who understand that one's best investments are made when a market is this negative, especially when a positive surprise could bring about a significant re-rating.*

In SA, the ongoing privatisation of energy could mean reduced or very low levels of loadshedding by the end of 2024. In a plethora of negativity, the financial sector continues to perform well and is well positioned to benefit from any good news (e.g. the impact of lower loadshedding levels) plus the probability of improved effectiveness of Transnet as a result of private sector involvement.

The 20-year track record of the Fund and current very attractive valuations give us the confidence to expect continued good returns from the sector and the Fund for 2023 and thereafter.

## Responsible Investment Comments

During the quarter we engaged quite extensively with members of the Investec Board of Directors on their ESG roadshow, given some concerns around their remuneration policy. One of the key points raised was that the Group Executive's quantum of remuneration was abnormally high. Along with other shareholders, we did raise arguments against this which included introducing alternative measures to assess management's performance more appropriately (e.g. economic value added).

Upon reviewing the remuneration report and the presentation from the board to shareholders, discretion was applied to both the short-term incentive (STI) and long-term incentive (LTI) portions of remuneration. We believe there was a robust discussion around the level of the Group Executives' remuneration as well as whether it was justified through managements' own performance or whether external factors (e.g. higher interest rates) contributed. A large portion of the LTI is due to share price appreciation and benchmarking Investec versus both UK and SA peers clearly illustrates how the Investec share price (both Plc and Ltd) significantly outperformed peers.

We were encouraged by the openness of the non-executive directors and their willingness to discuss alternative performance measures. In our view this points to strong corporate governance and the willingness of shareholders to collaborate positively with the Board of Directors in order to act as responsible investment custodians.





## Disclaimer

### WHO WE ARE

Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. It is a member of the Association of Savings & Investment South Africa (ASISA)..

### OUR TRUSTEE

The Standard Bank of South Africa Limited is the registered trustee.

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### HOW ARE OUR FUNDS PRICED

Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

### FEES

A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

### DISCLAIMER

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

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